UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

In re BEAR VALLEY FAMILY LIMITED PARTNERSHIP, Debtor.	Case No. 2:12-bk-15621-RK Chapter 11 AMENDED MEMORANDUM DECISION RE: MOTION OF RONEN ARMONY FOR SANCTIONS PURSUANT TO FED. R. BANKR. P. 9011

This case came on for hearing before the undersigned United States Bankruptcy Judge on May 1, 2012 on the motion of Ronen Armony for sanctions against Gary Kanter, who, as the managing member of VV Bear Valley, LLC, the general partner of the debtor Bear Valley Family Limited Partnership, signed the bankruptcy petition on behalf of debtor, and Christopher Walker, general bankruptcy counsel for debtor, pursuant to Rule 9011 of the Federal Rules of Bankruptcy Procedure. Brent H. Blakely and Courtney Stuart-Alban, of the law firm of Blakely Law Group, appeared for movant Armony. Christopher P. Walker, Law Office of Christopher P. Walker, appeared for respondent Kanter and for himself.

BACKGROUND

On December 29, 2011, the court entered its Memorandum Decision on Armony's motion to dismiss this bankruptcy case and its order dismissing the case, which was tried before the court. *Memorandum Decision re Motion to Dismiss,* filed on December 29, 2011 ("Memorandum Decision"). On February 28, 2012, Armony filed the instant motion for sanctions against Kanter and Walker in the amount of $133,880.43, representing the costs and fees he contends were caused by the allegedly improper bankruptcy petition filed by Kanter and Walker on behalf of debtor.

The motion was noticed for hearing on March 27, 2012, but renoticed for hearing on May 1, 2012. The court heard the argument of the parties at the hearing on May 1, 2012. At the hearing on May 1, 2012, the court requested the parties to file supplemental briefing addressing the specific factors considered by the courts for the imposition of sanctions under Rule 9011 of the Federal Rules of Bankruptcy Procedure and Rule 11 of the Federal Rules of Civil Procedure. The parties filed supplemental briefs on May 15, 2012, May 29, 2012, and June 5, 2012. On August 27, 2012, Armony lodged a proposed order for granting the motion, and on September 5, 2012, Kanter and Walker filed an objection to Armony's proposed order.

After carefully considering the parties' initial and supplemental briefing and the oral and written arguments of the parties, the court now takes the motion under submission and rules on the motion.

The court concludes that Armony's sanctions motion should be denied because debtor's bankruptcy petition was, at least partially, filed for the proper bankruptcy purpose of reorganizing its business to pay its creditors through collection of rental income on the properties located in Victorville, California. Armony purchased the properties—Pads 4 and 6—but purportedly did not fully paid for them, and debtor restructured the mortgage debt on the properties to avoid foreclosure. The listing of the properties on debtor's list of assets in its bankruptcy schedules was not frivolous since debtor had a reasonable basis in fact and law for claiming some ownership in the properties.

ANALYSIS

Rule 9011(c) of the Federal Rules of Bankruptcy Procedure expressly provides that if there is a violation under the rule, sanctions are discretionary, and the court may impose sanctions. Fed. R. Bankr. P. 9011(c); *see also*, *10 Resnick and Sommer, Collier on Bankruptcy*, ¶ 9011.06[1] at 9011-16 (16th ed. 2012). "In determining whether sanctions are warranted under Rule 9011(b), we 'must consider both frivolousness *and* improper purpose on a sliding scale, where the more compelling the showing as to one element, the less decisive need be the showing as to the other.'" *Dressler v. The Seeley Co. (In re Silberkraus)*, 336 F.3d 864, 870 (9th Cir. 2003), *citing*, *Marsch v. Marsch (In re Marsch),* 36 F.3d 825, 830 (9th Cir.1994) (emphasis in original). "The courts have interpreted Rule 9011 in the same way as the courts have interpreted Civil Rule 11 as establishing an objective standard of conduct for litigants and attorneys." *10 Resnick and Sommer, Collier on Bankruptcy*, ¶ 9011.04[3] at 9011-9, *citing inter alia, Business Guides, Inc. v. Chromatic Communications Enters., Inc.,* 498 U.S. 533 (1991), (Civil Rule 11); *see also, Miller v. Cardinale (In re DeVille),* 361 F.3d 539, 550 n. 5 (9th Cir. 2004) ("The language of Fed. R. Bankr. P. 9011 parallels that of Fed. R. Civ. P. 11, so courts analyzing sanctions under Rule 9011 commonly rely on cases interpreting Rule 11."), *citing, Valley National Bank of Arizona v. Needler (In re Grantham Brothers)*, 922 F.2d 1438, 1441 (9th Cir. 1991). If a pleading is "interposed for any improper purpose," it is sanctionable even if it is warranted by existing law and supported by the facts. *Mars Steel Corp. v. Continental Bank N.A.*, 880 F.2d 928, 931–932 (7th Cir. 1989). On the other hand, a pleading filed with the purest of intentions is sanctionable if its assertions and arguments lack a reasonable basis in fact and law. *Id.* at 932. Moreover, "[w]hile either prong is alone sufficient to warrant a sanction, this court must consider both because of the effect on the nature and severity of the sanction." *In re Grantham Brothers*, 922 F.2d at 1441.

In considering whether sanctions should be imposed and what sanction to impose, the 1997 Advisory Committee note to Rule 9011 suggests various factors for a court to

consider, including the following: (1) whether the improper conduct was willful or negligent; (2) whether it was part of a pattern of activity or an isolated event; (3) whether it infected the entire pleading or only one particular count or defense; (4) whether the person has engaged in similar conduct in other litigation; (5) whether it was intended to injure; (6) what effect it had on the litigation process in time or expense; (7) whether the responsible person is trained in the law; (8) what amount, given the financial resources of the responsible person, is needed to deter that person from repetition in the same case; and (9) the amount needed to deter similar activity by other litigants. 1997 Advisory Committee Note to Fed. R. Bankr. P. 9011, *reprinted in 10 Resnick and Sommer*, *Collier on Bankruptcy,* ¶ 9011.RH[4] at 9011-29–9011-30. The court finds that the existence of a number of these factors does not warrant the granting of the motion and the imposition of sanctions against Kanter and Walker.

In deciding whether to award sanctions, this court is mindful of the policy that "[p]arties must be allowed to fully advocate the position of their client within the parameters of Bankruptcy Rule 9011 without the specter of fee awards looming in the shadows." *In re Nichols*, 221 B.R. 275, 279 (Bankr. N.D. Okla. 1998). Accordingly, the advancement of a "colorable argument" is sufficient in and of itself to deny the award of attorneys' fees. *Id., citing, In re Edmonds,* 924 F.2d 176, 181–182 (10th Cir. 1991). "Bankruptcy Rule 9011 sanctions should not be utilized to penalize attorneys for taking novel, innovative positions." *In re Nichols*, 221 B.R. at 279*, quoting, In re Kaliana*, 207 B.R. 597, 603 (Bankr. N.D. Ill. 1997). Thus, "[t]he mere absence of legal precedent, the presentation of unreasonable legal argument, or the failure to prevail on the merits of a particular contention does not justify the imposition of sanctions." *In re Nichols*, 221 B.R. at 279. Similarly, because the "standards for dismissing a case under [11 U.S.C.] § 1112(b) are different from the standards used to impose sanctions under Bankruptcy Rule 9011," the fact that a case is dismissed "does not and should not automatically result in the imposition of sanctions." *In re Southern California Sound Systems, Inc.*, 69 B.R. 893, 901 (Bankr. S.D. Cal. 1987).

As discussed below, based on applying the factors outlined in the 1997 Advisory Committee note, Armony's motion for sanctions should be denied.

A. Whether the Improper Conduct was Willful or Negligent

Debtor's efforts to reorganize its business, including (1) its attempt to collect rental income on the properties it sold to Armony, Pads 4 and 6—but not fully paid for by Armony, with the balance of the purchase price owed to an entity related to debtor (RL Management, controlled by Kanter)—and (2) its attempt to restructure and pay the mortgages on the properties to avoid their foreclosure, were not willfully or negligently improper. *Bear Valley Family Limited Partnership, Gary Kanter, and Christopher P. Walker's Opposition to Motion for Sanctions Pursuant to Federal Rules of Bankruptcy Procedure 9011*; *Declaration of Gary Kanter and Declaration of Christopher P. Walker in Support of Opposition ("Opposition to Motion for Sanctions")*, filed on April 17, 2012, at 1–14, 18–22, *Kanter Declaration* ¶ 1–14 and *Walker Declaration* ¶ 1–6. This was Debtor's stated purpose in filing the bankruptcy case. *Id.* While the court eventually dismissed the debtor's bankruptcy case because it had sold the properties and actually conveyed title to the properties to Armony upon the sale, the debtor arguably had a colorable claim to the properties based on the Mediation Agreement & Settlement document signed by Armony and Kanter and the conduct of the parties. *See, e.g.*, *Kanter Declaration* ¶ 2–6; *Walker Declaration* ¶ 4–6; *Exhibit 1 to Opposition to Motion for Sanctions, Mediation Agreement & Settlement* at 1 ¶ 2.

The evidence in this case indicates the following facts, which are based on the Kanter and Walker Declarations filed in opposition to the motion and the testimony of Kanter and Armony during the evidentiary hearings on Armony's motion to dismiss the bankruptcy case on October 21, 2011 and November 1, 2011 (copies of the trial transcripts are attached to Armony's moving papers). Kanter and Armony had prior business dealings, which included sale of the subject properties by Kanter to Armony through controlled entities, including debtor (the court is aware of the dispute between Kanter and Armony as to control of debtor). *See also, Kanter Declaration* ¶ 4. Kanter,

through debtor, purchased the properties with financing (i.e., loans secured by trust deeds in the name of debtor in favor of the lenders), and then sold the properties to Armony with seller financing secured by trust deeds junior to the existing loans secured by trust deeds executed by debtor. Debtor formally transferred the properties via grant deeds to Armony and his controlled entities, and the deeds remained unrecorded for a long time because Kanter and Armony agreed not to trigger a material default on existing senior secured financing on the properties, leaving debtor as the record title owner. Armony did not pay for the properties in full and was in apparent default on the seller financing secured by the junior trust deeds, which were not held by debtor, but transferred to another entity controlled by Kanter, RL Management. The existing loans secured by senior trust deeds were not paid and were in default, threatening the properties (and the lien interests of Kanter and his related entities, including debtor) with foreclosure. The evidence also indicates that entities controlled by Kanter related to debtor had contractual rights to payment by Armony of the purchase price, which included trust deeds on the properties, and debtor and its related parties, including Kanter, intended to ensure payment of the mortgages for which it was liable and to prevent foreclosure in order to pay creditors. *See also In re Park Place Associates*, 118 B.R. 613, 618–619 (Bankr. N.D. Ill. 1990) (denying sanctions where debtor filed for bankruptcy "to obtain time to explore the possibilities of reorganization, not to inflict costs on [the creditor]").

That debtor, or its principal, Kanter, and its attorney, Walker, listed the properties on its asset schedules was likewise not willful or negligently improper. Based on the Mediation Agreement & Settlement and the conduct of the parties, Kanter had a reasonable basis in fact to conclude that the mediation agreement and settlement between him and Armony granted him contractual rights to the properties either on his own or through his controlled entities, such as debtor. *Opposition to Motion for Sanctions* at 18–22, *Kanter Declaration* at 1–4 and *Walker Declaration* at 1–2; *Mediation Agreement & Settlement, Exhibit 1 to Opposition to Motion for Sanctions* at 18–22. In a factually

similar case, a district court in *In re Burdick Associates*, 150 B.R. 516 (E.D.N.Y. 1993) reversed the bankruptcy court's imposition of sanctions. *Id.* at 517. There, the debtor filed a voluntary Chapter 11 bankruptcy petition and listed a piece of property as the sole asset of the partnership. *Id.* The lienholders on the property opposed the bankruptcy filing, seeking a declaration that the property was not property of the debtor's bankruptcy estate as well as an order dismissing the bankruptcy. *Id.* The bankruptcy court found that debtor divested itself of title years earlier in a deed conveying the property to three individuals as "tenants in common." *Id.* As a result, the bankruptcy court dismissed the case and imposed sanctions on the debtor for claiming the property as partnership property without a reasonable basis in law or fact. *Id.* The district court, however, reversed the imposition of sanctions, concluding that "[t]he Bankruptcy Court erred by finding that the deed was the only evidence it could rely on in reaching a decision," and determined that the bankruptcy court could have looked at other extrinsic evidence indicating the deed was not intended to divest the debtor of title, but meant only to change the name, and that therefore, debtor's argument that the property was an asset of the debtor was "grounded in both fact and law." *Id.* at 517–519.

In this case, the argument of Kanter and Walker that the properties were assets of debtor's bankruptcy estate based on the Mediation Agreement & Settlement and other conduct of the parties was also reasonably grounded in law and fact. *Opposition to Motion for Sanctions* at 18–22, *Kanter Declaration* at 1–4 and *Walker Declaration* at 1–2.; *Mediation Agreement & Settlement, Exhibit 1 to Opposition to Motion for Sanctions.* As in New York, presumptions of property ownership in California can be overcome "by evidence of an agreement or understanding between the parties that the title reflected in the Deed is not what the parties intended." *In re Marriage of Fossum*, 192 Cal. App. 4th 336, 345 (2011), *quoting*, *In re Marriage of Brooks and Robinson*, 169 Cal. App. 4th 176, 189 (2008). Furthermore, the facts in this case demonstrate that Kanter and Walker had a reasonable basis to believe debtor owned the properties. First, the mediation agreement between Armony and Kanter contained a paragraph providing for a split in

ownership of the properties and mentioning, within the same paragraph, both Armony and Kanter, and their "owned or otherwise controlled" entities, such as debtor. *See Mediation Agreement & Settlement, Exhibit 1 to Opposition to Motion for Sanctions* at 1. Second, because Kanter and Armony had agreed that Armony was not to record the grant deeds transferring title from debtor to himself or his controlled entities in order to prevent a material default on the existing secured financing on the properties, debtor remained the title owner of record until Armony later recorded the grant deeds. *See also, Opposition to Motion for Sanctions* at 18–22, *Kanter Declaration* at 1–4 and *Walker Declaration* at 1–2; *Mediation Agreement & Settlement.* Third, the modified loan documents with one of the senior secured lenders, Bank Midwest N.A., which were signed during the mediation agreement negotiations in 2010 and more than a year after Armony was deeded the properties, listed debtor as the borrower and Ben Kanter and Gary Kanter as guarantors. *See also, Agreement to Modify Loan, Exhibit 2 to Opposition to Motion for Sanctions* at 1. Fourth, debtor had already successfully defended against several motions for preliminary injunctions in state court regarding the disposition of the properties. *See also, Kanter Declaration* ¶ 8. Fifth, a lease agreement, signed by Armony on behalf of debtor shortly after execution of the mediation agreement, indicates that debtor is the owner of the leased properties. *See also, Lease Agreement, Exhibit 8 to Opposition to Motion for Sanctions* at 1, 39. Furthermore, evidence presented by debtor indicates that Armony and Kanter had entered into a similar ownership arrangement in the past whereby Armony was made a partner of the legal entity that continued to own the property and remained liable on the loan documents. *See also, Kanter Declaration* ¶ 7. As such, Kanter and Walker had a reasonable basis in law and fact to conclude that debtor had contractual rights to the properties and therefore, claiming ownership of the properties on debtor's bankruptcy schedules was not willful or negligently improper. Given the course of conduct between Kanter and Armony in their business dealings involving the debtor and other joint ventures, the use and manipulation of shell entities by both parties in these business dealings, including the debtor, and the

need to involve the debtor in restructuring the mortgage loans in its name on the subject properties, the court concludes that this is not an appropriate situation for the imposition of sanctions because there is some reasonable basis in fact and law for filing a Chapter 11 bankruptcy petition for the debtor.

Armony contends that Kanter and Walker may be sanctioned under the authority of *Blue Pine Group, Inc. v. Humitech (In re Blue Pine Group, Inc.)*, 457 B.R. 65 (9th Cir. BAP 2011). The instant case, however, is distinguishable from *Blue Pine Group, Inc.* The debtor corporation there was sanctioned for filing a bankruptcy case without proper corporate authorization—the same issue this court did not decide, but passed on for being "more appropriately adjudicated in the pending state court action." *Memorandum Decision* at 4–5.

B. Whether it was Part of a Pattern of Activity, or an Isolated Event

Armony has not proven that debtor's bankruptcy petition caused by Kanter and Walker and debtor's claim of ownership of the properties was part of a pattern of improper activity. Armony first asserts that the filing of the bankruptcy petition by Kanter and Walker was part of a pattern of wrongful activity because it helped them achieve their broader goals of avoiding the pending state court litigation regarding the properties and forcing him to litigate the issue of property ownership in this court. This argument fails on several fronts. First, the parties did not avoid the pending state court litigation upon filing the bankruptcy petition, since the debtor removed the state court proceedings to this court. As such, Armony could have pursued his state court claims in this court had he desired to do so. And second, forcing an opposing party to litigate an issue of property ownership when both parties have some reasonable basis in fact to claim ownership is not indicative of wrongful activity.

Furthermore, that Kanter was sanctioned in two other cases for discovery violations and filed for bankruptcy in another two cases does not demonstrate a pattern of wrongful activity. The imposition of sanctions in discovery disputes is not uncommon. Two discovery sanctions imposed in unrelated cases do not comprise a "pattern of

activity." Moreover, both of the prior bankruptcy cases filed by Kanter led to a consensual reorganization of debt between the debtor and the lenders. Thus, the court concludes that no pattern of wrongful activity has been demonstrated on the part of Kanter and Walker.

C. Whether it Infected the Entire Pleading or Only One Particular Count or Defense

Determining ownership of the properties was not the purpose of Kanter and Walker filing the bankruptcy petition on behalf of debtor. Rather, they sought to reorganize debtor's business to pay its creditors based on collection of rents from the properties, which Armony had not fully paid for and owed money to an entity related to debtor and controlled by Kanter. Debtor attempted to restructure and pay the mortgages on the properties to avoid foreclosure; avoiding loss of those properties was the central goal of the bankruptcy filing. *Opposition to Motion for Sanctions* at 1–14, 18–22; *Kanter Declaration* at 1–4 and *Walker Declaration* at 1–2. In fact, the parties were already litigating title to the properties in state court where debtor had successfully defended against several motions for preliminary injunction. Furthermore, debtor circulated a stipulation to relief from the automatic stay to allow the bank to collect all of the rents in exchange for delaying foreclosure proceedings. *See Walker Declaration In Support of Supplemental Opposition* ¶ 7. Armony refused to sign the stipulation, which necessitated litigation of title in this court. *Id.* Thus, the record indicates that the issue of who owned title to the properties was for Kanter and Walker a secondary issue to the main goal of reorganizing the business through collection of rents and restructuring of mortgage payments to pay the creditors of the debtor. As such, any improper listing of the properties as assets of the debtor on the bankruptcy petition filed by Kanter and Walker on behalf of debtor did not infect the entire bankruptcy case.

D. Whether the Person has Engaged in Similar Conduct in Other Litigation

As already discussed, the court rejects Armony's argument that Kanter engaged in similar wrongful conduct in other litigation when both Kanter and the opposing party

received discovery sanctions. The impropriety of a sanctionable objection to discovery requests is not similar or comparable to improperly listing, in good faith, an asset on a bankruptcy debtor's schedules. Similarly, the fact that Kanter had filed bankruptcy petitions on two prior occasions, both resulting in successful reorganizations, is not evidence of wrongful conduct. While it is true that the court dismissed the 395 Management bankruptcy case, the court stayed the dismissal due to debtor's compliance with the court's order. Thus, Kanter and Walker have not engaged in similar wrongful conduct in other litigation.

E. Whether it was Intended to Injure

Debtor's intent to reorganize by collecting rents and restructuring and paying its mortgages does not evince an intent by Kanter and Walker to injure Armony. Armony contends that Kanter and Walker intended to injure him by forcing him to spend over $100,000 in this court litigating ownership of the properties. However, had debtor not filed for bankruptcy, the same issues that were adjudicated in bankruptcy court would have had to be adjudicated in the state court, as they were the same issues in Armony's complaint in that court. Thus, the attorneys' fees would have been incurred either way, regardless of this bankruptcy filing.

F. What Effect it had on the Litigation Process in Time or Expense

As previously mentioned, the bankruptcy filing had little impact on the time or expense of the litigation process. The issue of ownership that was litigated in bankruptcy court would have been litigated in state court anyway. Thus, Armony did not incur any additional expenses in time or money by litigating ownership issues in this court.

G. Whether the Responsible Person is Trained in the Law

Kanter is not trained in law; and even assuming that Walker, debtor's attorney, is responsible for the decision of debtor to file for bankruptcy and to include the properties as assets in its schedules, debtor had a reasonable basis in fact and law to claim ownership over the properties, based on the Mediation Agreement & Settlement and the conduct of the parties. Debtor's claim of ownership under theories of "executory contract

rights" and "third party beneficiaries" reasonably constituted "nonfrivolous argument[s] for the extension, modification, or reversal of existing law or the establishment of new law," because the evidence indicates that Kanter through his controlled entities may have lien rights in the properties based on seller financing he made to Armony, though the precise lienholding entity may no longer have been the debtor. Fed. R. Bankr. P. 9011(b)(2); *see also In re Southern California Sound Systems, Inc.*, 69 B.R. at 901 (refusing to conclude that debtor's bankruptcy petition was filed without a good faith belief that it represented an extension of existing law, where case was dismissed, the case law permitted "rejection of personal service contracts," and rejection of a personal service contract was debtor's sole motivation for filing a petition under the Bankruptcy Code).

H. What Amount is Needed to Deter Similar Activity

Because the court finds that the conduct of Kanter and Walter is not sanctionable, there is no need to evaluate the amount needed to deter similar conduct in this case by them. *See In re Nichols*, 221 B.R. at 279 ("Parties must be allowed to fully advocate the position of their client within the parameters of Bankruptcy Rule 9011 without the specter of fee awards looming in the shadows.").

This memorandum decision constitutes the court's findings of fact and conclusions of law. The court will enter a separate final order denying the motion.

IT IS SO ORDERED.

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DATED: October 1, 2012

United States Bankruptcy Judge

NOTICE OF ENTERED ORDER AND SERVICE LIST

Notice is given by the court that a judgment or order entitled (*specify*) **AMENDED MEMORANDUM DECISION ON MOTION OF RONEN ARMONY FOR SANCTIONS PURSUANT TO FED. R. BANKR. P. 9011** was entered on the date indicated as "Entered" on the first page of this judgment or order and will be served in the manner indicated below:

I. SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s), the foregoing document was served on the following person(s) by the court via NEF and hyperlink to the judgment or order. As of **October 1, 2012**, the following person(s) are currently on the Electronic Mail Notice List for this bankruptcy case or adversary proceeding to receive NEF transmission at the email address(es) indicated below:

Robert D Bass rbass@greenbass.com
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II. SERVED BY THE COURT VIA U.S. MAIL: A copy of this notice and a true copy of this judgment or order was sent by U.S. Mail, first class, postage prepaid, to the following person(s) and/or entity(ies) at the address(es) indicated below:

Bear Valley Family Limited Partnership
2651 Irvine Avenue, Suite 141
Costa Mesa, CA 92627

III. TO BE SERVED BY THE LODGING PARTY: Within 72 hours after receipt of a copy of this judgment or order which bears an "Entered" stamp, the party lodging the judgment or order will serve a complete copy bearing an "Entered" stamp by U.S. Mail, overnight mail, facsimile transmission or email and file a proof of service of the entered order on the following person(s) and/or entity(ies) at the address(es), facsimile transmission number(s) and/or email address(es) indicated below: